

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Notice of Inquiry re: Provision of Default)	
Service)	D.T.E. 02-40-B
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INITIAL COMMENTS OF NSTAR ELECTRIC

Date: May 28, 2003

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I. INTRODUCTION

NSTAR Electric¹ (“NSTAR Electric” or the “Company”) hereby submits initial comments in response to the issues raised by the Department of Telecommunications and Energy (the “Department”) in its May 15, 2003 technical conference (the “Technical Conference”) regarding its investigation into the provision of Default Service. Specifically, the Technical Conference focused on the Department’s request for comments in its April 24, 2003 order in Notice of Inquiry re: Provision of Default Service, D.T.E. 02-40-B (the “Order”) on the appropriateness of monthly Default Service supply procurements for commercial and industrial (“C&I”) customers. Order at 40. NSTAR Electric is pleased to offer the following comments regarding Default Service procurement in order to further the orderly and effective development of a competitive retail market for the benefit of customers.

In the Order, the Department stated that, in comments submitted to the Department during the first phase of this proceeding, “a persuasive, though not yet convincing, case can be made for the proposition that a procurement term of one month

¹ NSTAR Electric is composed of Boston Edison Company, Cambridge Electric Light Company and Commonwealth Electric Company.

would: (1) provide efficient price signals to customers because the resulting prices would track wholesale market price on a monthly basis; (2) provide customers with an appropriate level of price certainty; and (3) provide appropriate protection from spot market price volatility.” Id. at 39. The Department elaborated on the concept of a monthly Default Service procurement policy, whereby distribution companies would procure their Default Service supply one month in advance on an on-going basis. Id.² The Department noted that, from the customers’ perspective, Default Service prices would be known for the next month only and, therefore, customers seeking price certainty might turn to the competitive market for longer term supply options. Id.

However, the Department did not order distribution companies to institute monthly Default Service procurement, noting the logistical issues that would arise if the Department’s current policy directing distribution companies to procure Default Service supply for a period of up to six months were to be changed at this time. Id. NSTAR Electric agrees with the Department that increasing the frequency of Default Service procurements may offer benefits to some customers, particularly larger C&I customers. However, the logistical issues alluded to by the Department in the Order are real, and could be mitigated by allowing distribution companies to institute quarterly, rather than monthly, Default Service solicitations, at least on a transitional basis. The Company’s rationale supporting this recommendation is outlined below.

² As discussed herein, the Department did not elaborate regarding how the current policy requiring distribution companies to notify customers 30 days in advance of a change in Default Service prices would be achieved with a monthly procurement policy.

II. QUARTERLY DEFAULT SERVICE PROCUREMENT WILL PROVIDE MEASURABLE BENEFITS FOR LARGER CUSTOMERS THROUGH BETTER PRICE SIGNALS WHILE MINIMIZING COSTS

In its Initial Comments filed in this proceeding on August 9, 2002, NSTAR Electric advocated that, in evaluating proposals for structuring Default Service, the Department should apply a standard that will result in measurable benefits to customers (Investigation Into Default Service, D.T.E. 02-40 (August 9, 2002 Initial Comments of NSTAR Electric at 3)). Consistent with this recommendation, the Company stated that:

changes to the Department's current policy regarding procurement strategies should be considered because of the possible customer benefits that might be realized with additional procurement options...[including allowing] quarterly or "staggered" procurement schedules with longer-term procurements for residential customers and relatively shorter-term procurements for commercial and industrial customers. This flexibility in Default Service procurement would allow distribution companies to make purchases that are in the customers' best interests and that would result in the lowest reasonable price for customers (id. at 10).

Accordingly, the Company agrees with the Department that allowing procurement of Default Service for large C&I customers for terms shorter than six months may provide better price signals to these customers, and thus, result in customer benefits by establishing Default Service prices that may provide incentives to customers to turn to the competitive market for other electricity options. However, as noted above, the Company's recommended frequency for Default Service solicitations for larger customers was (and is) quarterly, rather than monthly.³ A quarterly Default Service procurement policy is consistent with the Department's goal of establishing better price

³ In addition to NSTAR Electric and other distribution companies, other parties to this proceeding fully or partially recommended at the Technical Conference that the Department adopt a quarterly Default Service procurement policy, including Power Options (Tr. 2, at 152), Constellation Power Source (id. at 169-170), Coral Power (id. at 176) and Associated Industries of Massachusetts (id. at 186).

signals for customers in order to remove obstacles to the development of the competitive market, and thus, provide customer benefits. Moreover, a quarterly Default Service procurement policy alleviates some practical administrative issues that would arise in the context of monthly Default Service procurements. As discussed herein, NSTAR Electric believes that the goal of achieving better price signals for customers can be effectively balanced against the logistical obstacles of more frequent Default Service solicitations if the Department allows distribution companies to solicit for Default Service supply quarterly, but with Default Service prices varying on a monthly basis.

A. Monthly Default Service Procurement Will Significantly Compress the Time Available to Solicit For, Review, Negotiate and File Default Service Supply Contracts.

The procurement process for Default Service supply involves several procedures that are necessary regardless of the frequency of solicitations. NSTAR Electric's procedures and typical time line for: (1) procuring Default Service supply on a semi-annual basis; and (2) notifying customers of forthcoming Default Service price changes is, as follows:

- (1) update request for proposals ("RFP") and proposed contract (10 business days);
- (2) issuance of the RFP and the bidding period (10 business days);
- (3) receipt of bids, bid review and management approval (5 business days);
- (4) contract negotiations with the winning bidder or bidders (10 business days);
- (5) preparation of Default Service supply contract filing to the Department (3-5 business days);
- (6) Department review and approval (5 business days); and
- (7) customer notification of change in Default Service price (30 days).

Accordingly, the solicitation, review and approval process currently takes approximately 45 business days (two months) to complete. The customer notification period adds an additional 30 calendar days. Although this process could be compressed to some extent, if required, fitting the process into a monthly time frame poses risks to customers because of the importance of these procedures in securing the best proposals from suppliers and in facilitating the development of a comprehensive supply contract with clear and accurate terms. For example, the preparation of an RFP and proposed contract requires a thorough analysis of legal, regulatory and market issues in order to update the documents properly prior to a solicitation. Further, once the RFP is issued, suppliers require sufficient time to prepare and offer bids to the distribution companies.

However, the most important procedure involved in developing a final Default Service supply contract is the negotiation process between the distribution companies and winning bidders. Currently, the negotiation of appropriate contracts to deal with the wide variety of issues that arise is a difficult and necessary undertaking. In addition to negotiating price terms during this process, liability issues, financial security provisions, and allocation of duties between the parties are each negotiated before a final contract is signed. Agreements on these and other issues ensure the orderly and efficient provision of Default Service between distribution companies and suppliers, as well as inevitably produce lower prices to customers. Therefore, an adequate amount of time must be available to both distribution companies and suppliers to properly negotiate the terms of supply contracts.

Moreover, because of the importance of the negotiation process in developing thorough and clear Default Service supply contracts, NSTAR Electric believes that

standardized contracts are a prerequisite to any monthly procurement process, in order to reduce the variability of some issues that arise in the context of non-standardized contracts. However, even if all wholesale market participants were willing to develop a standardized contract (and it is unclear if they are), evolving wholesale-market rules could make the effort futile at the present time. For example, over the past several months alone, Independent System Operator-New England (“ISO-NE”) has implemented new rules relating to standard market design, zonal pricing and congestion costs. In addition, ISO-NE is currently considering new Designated Congestion Area rules and may decide issues over the coming 12 months regarding nodal pricing.⁴ These and other wholesale market rules are highly relevant to the terms of Default Service supply contracts and must be determined before an adequate standardized Default Service contract can be developed.⁵

In contrast, a quarterly procurement schedule allows sufficient time to properly solicit for, negotiate and seek approval of the current array of non-standardized Default Service supply contracts while allowing for better price signals to be available to customers than under the present procurement schedule. Without properly drafted contracts that address these issues up front, contract negotiations and contract administration with suppliers in a monthly solicitation process will be frustrated. In

⁴ ISO-NE has also implemented new rules recently regarding “reliability-must-run” costs, which relate to agreements between ISO-NE and generation companies requiring such generation companies to make available resources that may be required to run in order to ensure the reliability of the New England Power Pool system.

⁵ In addition to these practical administrative considerations, it must be noted that, to the extent that the Department institutes a monthly procurement policy, existing wholesale suppliers in the Massachusetts market may have an advantage over newer participants based on their collective experience to date negotiating Default Service supply contracts with the Massachusetts distribution companies. Accordingly, a monthly procurement policy may discourage new wholesale participants from entering the Massachusetts market.

addition, where these issues are not resolved, uncertainty and contract disputes are likely. At this point in the evolution of the market, there is still too much ongoing market change to enable the development of standardized contracts for Default Service. Accordingly, given these practical considerations, until standardized contracts can be developed and instituted, the Department should allow distribution companies to implement quarterly procurement schedules, as recommended by the Company in its August 2002 Initial Comments.

B. A Monthly Procurement Policy May Not Provide Sufficient Notification to Customers of the Subsequent Month's Default Service Prices.

A monthly Default Service procurement policy may not result in customer benefits to the extent that customers have insufficient opportunity to react to changes in monthly Default Service prices. The Department's current policy requires distribution companies to notify customers 30 days in advance of any change in Default Service prices. This policy recognizes that sufficient lead time must be built into the process of establishing Default Service prices so that customers have an adequate opportunity to seek competitive options in the market (see Tr. 2, at 152).

However, certain participants at the Technical Conference went so far as to suggest increasing the lead time for notifying customers of forthcoming Default Service price changes from 30 days to 45 or 60 days (see Tr. 2, at 153). Although NSTAR Electric believes that the Department's current notification period is adequate, the suggestion to increase the notification period reflects the importance of ensuring that customers can thoroughly analyze competitive supply options and negotiate contracts with retail suppliers.

Indeed, given the practical administrative issues addressed supra, in order to implement a system whereby a Default Service price is established monthly, not only would the solicitation, review and approval process need to be compressed significantly, notice to customers of monthly price changes would also need to be reduced drastically. Accordingly, a monthly procurement policy, combined with the Department's current 30-day notice requirement, would result in distribution companies either needing to procure Default Service supply at least two months prior to the effective date of new Default Service prices, thus eliminating the benefit that monthly procurement theoretically might achieve, or it will require the Department to substantially compress its requirements for notifying customers of Default Service pricing changes, which could provide disincentives for customers to seek competitive supply. In contrast, a quarterly process would not require significant changes for customers. Therefore, the Department should allow the distribution companies to implement quarterly procurement schedules in order to provide customers with the benefit of more accurate Default Service price signals, along with providing sufficient time to react to such signals with a thorough analysis of competitive options.

C. A Monthly Default Service Procurement Policy Is Inconsistent With the Best Operational Practices of ISO-NE.

Distribution companies could not follow ISO-NE's current best operational practices if they were required to implement monthly Default Service procurements. This issue arises in the context of ISO-NE's Installed Capacity ("ICAP") rules. At present, ISO-NE holds an ICAP auction for load-serving entities 15 to 17 days in advance of the subsequent month. As a result of this auction, a market participant is assigned ICAP responsibilities. In order to notify ISO-NE of those suppliers subject to bilateral

contracts for purposes of including them in the ICAP auction, ISO-NE's best operational practices require that the identity of the suppliers be provided to ISO-NE approximately 21 days prior to a contract's effective date.⁶

Therefore, because the Default Service solicitation, contract negotiation and Department approval process pursuant to a monthly procurement policy would likely take the better part of a month to complete, and ISO-NE requires suppliers that are parties to bilateral contracts be revealed approximately 21 days prior to a contract's effective date, a monthly Default Service procurement policy would be inconsistent with ISO-NE's best operational practices. Conversely, a quarterly procurement policy would allow distribution companies to provide bilateral contract-related notifications to ISO-NE in a timely manner consistent with ISO-NE's best practices.

D. Additional Issues Weigh in Favor of a Quarterly Procurement Policy.

In addition to the implementation issues noted supra, other policy considerations also weigh in favor of allowing a quarterly, rather than a monthly, Default Service procurement process. Distribution companies currently bid-out their respective six-month period Default Service supply needs at different times of the year, resulting in staggered procurement periods from the perspective of suppliers. In contrast, if a monthly Default Service procurement schedule were implemented, each of the distribution companies will be bidding-out their respective Default Service load at the same time each month and, therefore, 100 percent of Massachusetts Default Service load

⁶ Although, as an alternative to the ICAP auction, ISO-NE allows suppliers to be assigned ICAP responsibilities through participation in a deficiency auction seven business days prior to the subsequent month, the deficiency auction is potentially riskier for suppliers to the extent that the ICAP available on a deficiency basis clears at a high price. Reliance on this approach would add uncertainty and additional cost in the long run to Default Service pricing for customers.

would be up for bid every month. This situation may disadvantage smaller distribution companies and complicate the process for suppliers.

For example, Fitchburg noted during the Technical Session that it may be seeking only 10 to 20 megawatts of Default Service supply during a given month, as compared to several hundred megawatts of supply that is likely to be sought by larger distribution companies during the same time frame (see Tr. 2, at 147). If so, wholesale suppliers may chose not to bid on Fitchburg's load, to the extent that efficiencies favor a wholesale supplier bidding only on the larger companies' loads. Under this scenario, smaller companies would be left to procure supply on the spot market, which includes significant financial assurance obligations and leaves unresolved how to price spot-market-procured supply at retail. As compared to a monthly procurement policy, the risks of failed Default Service supply auctions could be mitigated if the Department adopted a quarterly procurement policy and maintained staggered solicitation periods among the distribution companies.

In addition to the possible adverse impact of a monthly procurement policy on smaller distribution companies, the Department should implement a procurement policy that does not unnecessarily impose additional costs to customers. In order to transition from the current procurement policy to a monthly procurement policy, the distribution companies would likely need to invest in new resources. The increased costs associated with these necessary changes would be borne ultimately by customers through increased Default Service prices. Conversely, NSTAR Electric's current two month procurement time-frame and one month notification policy is essentially accomplished on a timetable that could be easily adapted to a quarterly procurement schedule using existing resources.

Accordingly, the Department should carefully weigh the cost implications of instituting a monthly procurement policy against the benefits of such a policy and determine that a quarterly procurement schedule better balances those interests.

E. The Department's Goals Can Be Achieved Most Efficiently if Default Service Is Obtained Through Quarterly Procurement.

The Department's goal of providing better Default Service price signals to customers can be achieved most efficiently through a quarterly Default Service procurement policy. Under a quarterly procurement policy, distribution companies would solicit for Default Service supply every three months and negotiate contracts for three months of Default Service supply. This would allow the distribution companies to notify large C&I customers and ISO-NE of Default Service price changes pursuant to current protocols, but provide large C&I customers with refreshed price points every three months, rather than every six months, as is provided currently.⁷

A quarterly procurement policy would: (1) address the logistical issues discussed above; (2) provide customers a better reflection of current market prices on a monthly basis; and (3) offer customers adequate time to react to such changes by analyzing market-based options. Moreover, customers that prefer the certainty of longer-term prices would be provided an incentive to secure longer-term supply through the competitive market, consistent with the Department's objectives. See Notice of Inquiry re: Provision of Default Service, D.T.E. 02-40-B at 39. Accordingly, the Department

⁷ Alternatively, if the Department believes that prices should be provided to customers closer to their effective date in order to provide incentives to customers to procure longer-term supply with known prices from the competitive market, distribution companies could solicit for and procure Default Service supply every three months, but identify the Default Service prices to customers on a monthly basis.

should allow distribution companies to procure Default Service supply through quarterly solicitations and provide customer notification of Default Service price changes every three months as described above.

III. CONCLUSION

NSTAR Electric agrees with the Department that establishing more frequent procurement of Default Service supply for large C&I customers can result in customer benefits by providing better price signals. However, the Department should consider the logistical obstacles involved in implementing a monthly procurement schedule as well as the policy and cost issues that would arise in the context of a monthly procurement schedule. Moreover, the Department should not adopt a policy whereby customer notification of Default Service price changes is reduced to a point at which customers cannot adequately review competitive options and respond to price signals.

Accordingly, the Department should allow distribution companies to achieve the Department's objective of providing better price signals to customers through the use of staggered, quarterly Default Service procurement schedules, rather than monthly procurement schedules. NSTAR Electric appreciates the opportunity to submit comments in this phase of the proceeding and looks forward to its continuing participating in the Department's consideration of Default Service issues.

Date: May 28, 2003